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MAR 05 1984

B. PROGRAM & STAFF RECOMMENDATIONS (CONT'D)2. Presentation on Royalty Sharing in Paraho Ute Oil Shale Project

This item was eliminated from the agenda.

3. Request for Relief of Minimum Royalty Payment on Tosco Oil Shale Lease

Tosco Corporation has requested that the Board of State Lands and Forestry amend the provisions of the unit agreement and cooperative plan of development for the development and operation of the Sand Wash Plan Area, Uintah County, Utah. Section 7 of this agreement provides that commencing January 1, 1984, the unit operator, Tosco corporation, will pay to the State of Utah either production royalties or minimum royalties equal to \$5 per acre and that these minimum royalties will be increased \$5 per acre per year until 1993 at which time the rental will be \$50 per acre. The argument that Tosco gives for this request is, first, that the payment of these minimum royalties would put Tosco at an economic disadvantage with the other oil shale operators in the Uintah Basin and, second, that the 1981 general session of the Utah Legislature amended Title 65-1-18, Utah Code Annotated, to limit the amount of minimum royalties which can be charged a mineral lessee to three times the annual rental, in this case it would be \$3.00 per acre. This unit agreement was approved by the Board in 1975 at the request of Tosco for the development of oil shale operations on certain State leases in central Uintah County. These leases were about to expire at that time, and the unit extended those leases. The Board at that time felt that, to insure the development of these properties, the unit operator should be required to make a development commitment which is contained in Section 8 of the agreement; and it required that the operator spend a minimum of \$8 million by December 31, 1984, toward the development of the leased area. It also provided for the payment of minimum royalties as outlined above.

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It is the feeling of Mr. Prince, of the Staff, that this agreement was entered into with Tosco knowing exactly what requirements they were going to have to live with and that they were willing to pay the amounts contained in the agreement for the privilege of retaining the oil shale leases on the State lands involved. It should not be the State giving up our benefits from this agreement because of economic conditions which now make the development of oil shale appear to be more in the future than it was at the time this agreement was approved. Mr. Prince submitted Tosco's proposal to the Attorney General's Office for their review as to the effect of the amendment of Title 65-1-18; and subject to their advice, it is Mr. Prince's recommendation that the request of Tosco Corporation be denied.

Tony Rampton, attorney for Tosco, and Mr. Dixon Shay, of Tosco Corporation, appeared before the Board to present their position. They gave the Board a written statement stating their position. Tosco believes that the deferrment request submitted to the Board should be granted for the following reasons (as taken from the written statement submitted to the Board):

"First, under present circumstances, the underlying rationale for Tosco's obligation to pay minimum royalties in lieu of production has been at least temporarily invalidated. Tosco originally offered to commit to royalty obligations in lieu of production to provide the State with a means for discouraging any inclination by Tosco to hold the leases committed to the Unit Agreement beyond their primary terms for speculative purposes. The need for this negative incentive was based, in part, on the assumption that, by 1983, shale oil could be profitably produced from the leases and that Tosco's leasehold position would, by then, be quite valuable. As indicated previously, however, Tosco does not presently have the option, despite vigorous planning and substantial investment in the project, to proceed with the construction and operation of the project on a profitable basis. The absence of serious bidding activity in response to the State's recent oil shale lease offering appears to confirm a significant decline in the perceived present value of the reserves. In addition, given present crude oil price projections, it is doubtful whether the reserves will experience any significant increase in value over the next several years. As a result, the minimum royalty obligation does not presently fulfill the original objective of discouraging speculative ownership. On the contrary, it significantly increases the cost of preserving the feasibility of the project at a time when cost control is of crucial importance to Tosco. Given the fourth to five year lead time required for plant construction and the general consensus that international oil prices will remain stable for at least the next two years, it is extremely unlikely that Tosco will be in a position to produce any shale oil from the Sand Wash leases any earlier than five to seven years from now.

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"Second, Tosco's performance to date has been completely inconsistent with any intent to hold the leases for speculative purposes. Under the Unit Agreement, Tosco agreed to make development expenditures for the project amounting to at least \$8 million by December 31, 1984. As indicated in the Progress Report submitted to the Division of State Lands and Forestry in April of 1983, Tosco has expended more than \$17 million in planning and development expenses by year end 1982. In addition to its engineering, environmental, permitting, and reserve consolidation activities, Tosco has qualified the project for energy tax credits which could be worth \$50 million to \$300 million, depending on the ultimate scale of the project. It is highly unlikely that the potential tax savings associated with these credits (which are equivalent to partial project financing) can be realized by any entity other than Tosco and its future joint venture partners.

"Third, Tosco's development work as a State tenant has materially enhanced the value of the State's reserve position. As shown on the map attached to this statement (note Attachment 1), the reserves originally leased by Tosco were scattered and noncontiguous. In a number of instances, the leases covered reserves too small and too isolated to warrant serious consideration as sites which could support commercial production. The ultimate reserve configuration which will result from Tosco's prior and on-going reserve consolidation program is shown on this map by the heavy dashed border. The consolidation should greatly reduce the cost and increase the efficiency of development operations conducted above and below ground at the Sand Wash Project. We believe that the State will continue to derive material benefits from Tosco's participation as a lease tenant in the future and that it is in the best interest of the State to preserve this relationship. . . particularly under the coordinated administration assured by the Unit Agreement.

"Fourth, the requested deferment is consistent with actions taken by the Board in response to the extension requests of other oil shale tenants. In these other cases, the Board has granted requests for extensions of the primary terms of leases in return for development expenditure commitments but without requiring payment of minimum royalties for acreage to be affected by the tenant's development plans during the period of the requested extensions. For example, in 1979 this Board extended for 10 years beyond their primary term (i.e., to December 31, 1993) Magic Circle's committed oil shale leases upon condition only that development expenditures in the amount of \$5 million be made by December 31, 1983. As indicated previously, Tosco's development expenditures already amount to more than twice the sums required by the Unit Agreement. Under the circumstances, we believe that a favorable response to the deferment request is both equitable and consistent with prior Board decisions.

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"Fifth, the impending exchange has raised a number of procedural issues which will have a significant impact on the future rights and obligations of both the State and Tosco. Settlement of these issues (which include choice of form of lease, magnitude and timing of rental and royalty payments, length of primary term of new leases, etc.) are not governed by the terms of the existing Unit Agreement, were largely unforeseen by the parties, and will require cooperation and compromise to resolve. In addition, neither Tosco nor the State knows exactly how much reserve acreage will be acquired by the State through the exchange. Tosco believes that it is inappropriate to require prepayment of minimum rentals and royalties for the year 1984 based upon reserve acreage which may not be finally determined until the second or third quarter of 1984.

"Sixth, as indicated by the recitals of the Unit Agreement, both parties acknowledged at the time of its execution that the agreement was experimental in nature and might have to be modified, from time to time, to protect the interests of the State of Utah. The State has a substantial interest in the potential success of the Sand Wash Project. At the present time, any material increase in the financial burdens associated with the leases and Unit Agreement will make it more difficult for Tosco to sustain its commitment to the project. The temporary alleviation of minimum royalty obligations sought by the deferment request will assure Tosco's ability to continue its participation as a tenant for at least an additional five years. As indicated previously, we believe that the State has benefitted from Tosco's participation in the past and will continue to do so in the future. We do not believe that the requested action will establish any damaging precedent for the Board because the Sand Wash Unit is at present a unique arrangement within the State of Utah. The structure of future oil shale unit agreements will tend to reflect the specific characteristics of the reserves committed to the units and the individual needs and objectives of the parties at the time of the negotiation of such agreements."

Mr. Shay noted that Tosco is also willing to make some concessions to the State in the preference-right lease by relinquishing 15 of the 20 years in the leases that they would acquire in the exchange. This would give the State the opportunity to release the lands after the five-year period if the unit should not succeed. After this land is blocked up, it will be the largest block of oil shale in the State. Mr. Prince, of the Staff, stated that the State now has four exchanges pending to acquire oil shale for different companies. Mr. Rampton stated that this project is in an advanced stage of readiness. They are only waiting for it to become economically viable to produce oil shale. Mr. Shay noted that a great many issues have arisen since the beginning of the exchange that were not covered by the agreement. Some of these have made it

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necessary to make this request. However, the Staff generally feels that there is adequate language in the unit agreement to cover these items. Mr. Shay stated this is a very difficult financial time for Tosco and this is the only reason they are requesting this. Mrs. Stirba noted that Section 65-1-18, Utah Code Annotated, states that the leases issued shall be for 20-year terms. However, there is another section of the code that permits the Board to modify lease terms when committed to a unit agreement and plan of operation. Mr. Rampton stated he does feel that the statute regarding unit agreements does give the Board authority to amend the lease terms through unit agreement. He also stated that there was some questions as to whether or not Section 65-1-18 applied to leases acquired under preference-right means.

After much discussion of this, the Board stated that they did have a responsibility to the trust, but that they were also very sympathetic to the financial status of Tosco. The Board generally felt that in essence we were in partnership with the development of the oil shale with Tosco and that we needed to help them when possible.

St. John/ Furse. Motion passed.

"I move we amend the royalty schedule to a rate of \$3.00 for the next five years with the provision that the preference-right leases be for five years as offered by Tosco and that if the leases are sold in the interim that we would revert to the royalty in the unit agreement schedule as per the original agreement."

Mr. Ross and Mr. Chase opposed. Mr. Rattle abstained.

It is the understanding of both parties that the following are the provisions which, if accepted by Tosco, would have to be met to meet the Board's requirements for approval of this request:

1. Minimum royalty rates for the next five years would be frozen at a fixed rate of \$3.00 per acre per year (the annual rental rate of \$1.00 per acre per year would be credited against this annual minimum royalty rate).
2. In 1989 royalty rates would increase to \$5.00 per acre per year and continue to escalate at a rate of \$5.00 per acre per year for the following nine years.
3. In the event that Tosco sells or assigns all of its interest in the unitized leases to a third party after the royalty rates are modified, the purchaser's minimum royalty rates would escalate, prospectively from the date of sale or assignment, to the present royalty rates in accordance with the current schedules (Tosco understands that such a sale or assignment could not be accomplished without the Board's consent).

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4. Tosco must relinquish through appropriate amendments to the Unit Agreement 15 years of the 20-year primary term for all new leases covering reserve acreage acquired through the exchange.

5. Tosco must accept the Board's offer on or before the Board's regular meeting in February.

6. Tosco's obligation to pay minimum royalty for 1984 (at either the existing \$5.00 rate or the proposed \$3.00 rate) will be postponed from January 1, 1984, to March 1, 1984, pending Tosco's consideration of the Board's counter-offer.

Tosco representatives noted that they would have to confer with their management people to see if this was an acceptable alternative for them. The Board gave administrative authority to the Director to defer the January royalty payment.

Bernarr / Sawyers. Unanimously approved.

"I move we defer the January minimum royalty payment for 60 days to allow Tosco to confer with their management people on this proposal."

4. Creation of Area of Critical Environmental Concern - Bearclaw Poppy

The Staff briefed the Board in the September, 1983, Board Meeting about the possibility of creating an "area of critical environmental concern" to protect an endangered species, the Dwarf Bearclaw Poppy.

Mr. Carter, of the Staff, proposes to create an area of critical environmental concern to protect and aid in the recovery of the Dwarf Bearclaw Poppy, an endangered species endemic to the St. George area. Said proposal consists of two actions: 1 - Closure of area to off-road vehicle use; and 2 - Restrictions placed upon mining exploration and production. The areas where the poppy grows will be closed to all off-road vehicle traffic. The area will be signed and posted so the public will know that off-road vehicle use is prohibited on those lands. The area will be sporadically patrolled by Bureau of Land Management personnel and State Lands and Forestry personnel to determine if excessive use is occurring. If excessive use is occurring, it is proposed that the Division and the Bureau of Land Management will enter into a